

Investments

Background

In March 1997, GASB adopted Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* (effective for periods beginning after June 15, 1997). This statement established new accounting treatments and reporting requirements related to all investments held by governmental entities. Essentially GASB No. 31 requires governments to report investments at fair value in the balance sheet (or other statement of financial position). Thus, investment income and losses are recognized in the current period as revenue (or as contra revenues) without respect to the date of sale of the investment instrument. GASB No. 31 reporting requirements differ from previous investment reporting requirements where investment gains and losses were recognized in the period of the sale of the investment instrument (i.e., when realized).

Further, GASB also adopted Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, which became effective for periods beginning after December 15, 1995. This statement established reporting standards and disclosure requirements for securities lending transactions. In these transactions, governmental entities transfer their securities to broker-dealers and other entities for collateral and agree to return the collateral for the same securities in the future. The statement requires governments to report the securities received (as collateral) as assets on their balance sheets (if the government may incur risks or rewards from the collateral received). The statement does allow a cost basis for certain types of security lending transactions.

Accounting Treatment

Based on the accounting and reporting requirements associated with GASB Statement No. 31, LEAs should recognize all investment income, including changes in the fair value of investments, as revenue in the operating statement (or other statement of activities). Investments include:

- Interest-earning investment contracts
- External investment pools
- Open-end mutual funds
- Debt securities
- Equity securities (including unit investment trusts and closed-end mutual funds), option contracts, stock warrants, and stock rights that have readily determinable fair values

For reporting purposes, fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Certain exceptions to this general accounting treatment and related reporting requirements exist, and GASB No. 31 should be consulted for these exceptions and further detailed requirements.

Money market investments that are short-term (held less than 12 months) and highly liquid debt instruments (e.g., commercial paper, banker's acceptances, and U.S. Treasury and agency obligations) may be reported by governmental entities at amortized cost. In practice the administrative effort associated with the amortization of investment premiums and discounts for short-term investments has made this practice obsolete. Therefore, most governments now report all investments at fair value. Further, the differences between fair values and amortized costs do not materially affect the presentation of investment assets on the balance sheet.

Since GASB No. 31 allows for distinct treatments between short-term highly liquid investments and long-term investments, the account structure should allow for maximum flexibility in accounting for these investment types. Thus, we believe that the code structure should allow LEAs to track investment income at a detailed level (based on local preferences). All investment income (regardless of investment type), however, should be reported on a single line item on the operating statement.

GASB Statement No. 28 requires governments to report the assets received as collateral from securities lending transactions as assets on the balance sheet. These assets may include cash, securities or letters of credit. The rationale for this reporting requirement is that the government should report these assets if it has a potential for risk or reward from the securities (collateral). Thus, a government should report these transactions on the balance sheet only if it has a risk or reward associated with a change in value in the securities lending collateral. If no risk or reward can result from the transaction (e.g., when the collateral is a letter of credit), then the government does not report the related assets on the balance sheet. GASB does, however, require reporting of all security lending transactions in the footnotes of the financial statements.

Finally, it should be noted that states also have developed a range of investment restrictions and reporting requirements for local governments including LEAs. State statutes may require LEAs to report all investments at fair value regardless of the type or duration of the investment. State requirements should be followed by LEAs in determining the appropriate accounting treatment(s) for investments.

Proposed Handbook Revision

The GASB No. 31 reporting requirements have only minor implications for the current content of the account classification descriptions in the Handbook. Currently, three revenue codes exist within the Handbook to account for investment interest, dividends and gains/losses (Revenue codes 1510, 1520 and 1530). These codes are defined as follows:

Interest on Investments (1510).

“Interest revenue on temporary or permanent investments in United States treasury bills, notes, savings accounts, time certificates of deposit, mortgages, or other interest-bearing investments.”

Dividends on Investments (1520).

“Revenue from dividends on stocks held for investment.”

Gains or Losses on Sale of Investments (1530).

“Gains or losses realized from the sale of bonds or stock. Gains represent the excess of sale proceeds over cost or any other basis of the date of sale (cost less amortization of premium in the case of long-term bonds purchased at a premium over par value, or cost plus amortization of discount on long-term bonds purchased at a discount under par value). Gains realized from the sale of U.S. treasury bills represent interest income and should be credited to account 1510.

Losses represent the excess of the cost or any other basis at the date of sale (as described above) over sales proceeds.”

We propose the following Handbook revisions:

Interest on Investments (1510).

“Interest revenue on short-term investments (held for less than 12 months) in United States treasury and agency obligations, commercial paper, savings accounts, time certificates of deposit, mortgages, or other interest-bearing investments.”

Dividends on Investments (1520).

No change

Fair Value Gains or Losses on Investments (1530).

“Gains or losses recognized from the sale of investments or changes in the fair value of investments. Gains represent the excess of sale proceeds (or fair value) over cost or any other basis of the date of sale (or valuation). All recognized investment gains or losses may be accounted for utilizing this account; however, interest earnings from short-term investments may be credited to account 1510 (for tracking purposes only). For reporting purposes all investment gains and losses should be reported on a single line item as investment income in the operating statement.

Losses represent the excess of the cost or any other basis at the date of sale (or valuation) over sales proceeds (or fair value).”

Finally, we do not propose any changes to the Handbook code structure based on the reporting and disclosure requirements associated with GASB Statement No. 28. The accounting for securities lending transactions do not require distinct investment or gain/loss accounts. Rather, Statement No. 28 establishes reporting and disclosure requirements for this specialized type of investment transaction.

The need for guidance on the accounting treatments and reporting requirements for investment transactions by LEAs should be a topic that is explored in Phase II of this project. The proper accounting treatment for investment transactions should be addressed in the context of more global changes to the Handbook that will be explored at that time.

Coding Examples

1. An LEA invests \$20,000 in a state-run investment pool on 4/15/01. At fiscal year end (6/30/01), the fair value of the investment is \$22,800 based on reporting from the state investment pool.

At the date of the investment, the LEA would debit Investments (asset account 111) and credit Cash (asset account 101) for \$20,000.

On the LEA's balance sheet at fiscal year end, the investment would be shown to have a value of \$22,800. Thus, the LEA would recognize revenue from the investment of \$2,800 during the FY01 fiscal year by debiting Investments (asset account 111) and crediting Gains or Losses on Investments (revenue account 1530).

2. On 2/1/01 an LEA enters into a security lending transaction in which it transfers securities with a fair value of \$28,000 to a broker-agent for \$30,000 in cash (collateral). On 2/01/02 the LEA must repay the broker-agent \$30,000 in cash for return of the securities. According to the terms of the agreement, the LEA may invest the cash collateral during the period of the transaction. The LEA has a 6/30 fiscal year end.

On the date of the security lending transaction, the LEA debits Cash (asset account 101) for \$30,000 and debits Loans Payable (liability account 451). The LEA does not make an entry to remove the loaned securities from its balance sheet since it still has credit risks associated with these investments.

On 2/01/02 when the LEA repays the broker-dealer and receives its securities by exchange, the LEA would debit Loans Payable for \$30,000 and credit Cash.